IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

GIFT TAX REFERENCE No 3 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements? Yes

2. To be referred to the Reporter or not? Yes @be referred to the Reporter or not? Yes @be referred to the Rep rter or not? Yes @be referred to the Reporter or not? Yes @be referred to the Reporter or not? Yes @be eferred to the Reporter or not? Yes @be referred to the Repo ter or not? Yes @be referred to the Reporter or not? Yes @be referred to the Reporter or not? Yes @be r ferred to the Reporter or not? Yes @be referred to the Repor er or not? Yes @be referred to the Reporter or not? Yes @be referred to the Reporter or not? Yes @be re erred to the Reporter or not? Yes @be referred to the Report r or not? Yes @be referred to the Reporter or not? Yes @be referred to the Reporter or not? Yes @be ref rred to the Re

3. Whether Their Lordships wish to see the fair copy of the judgement? No

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? No

5. Whether it is to be circulated to the Civil Judge? No

COMMISSIONER OF GIFT-TAX

Versus

PUNJABHAI KALABHAI

Appearance:

MR MANISH R BHATT for Petitioner

SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE R.BALIA. and
MR.JUSTICE A.R.DAVE

Date of decision: 03/12/98

ORAL JUDGEMENT (per R. Balia, J.)

The Income Tax Appellate Tribunal, Ahmedabad Bench 'A', at the instance of Commissioner of Gift Tax, Rajkot, has referred following question of law arising out of its order dated 12.1.1984 in Gift Tax Appeal No. 26/Ahd/83 for A.Y. 1975-76.

"Whether, on the facts and in the circumstances of the case, the assessee was liable to tax under the Gift-tax Act, 1958?"

2. The assessee was a partner in a firm M/s. Dipak Solvent Extraction Industries, Manavadar, having share of 9% therein. He retired from the firm on 26.10.1973 at the close of previous year ending S.Y. 2029. The firm inducted 6 new partners with effect from 27.10.73 which included 3 sons of the assessee. The Income Tax Officer was of the view that the assessee retired from the firm without taking his share of goodwill from the above firm which amounted to relinquishing his right in the goodwill of firm in favour of incoming partners. By holding that right to share the profits of a firm is a valuable right which is capable of transfer, unless the transfer is made for full consideration in money or money's worth, the transfer would be liable to gift tax on the value of diminution of his share in the firm u/s 4 of the Gift-tax Act. He therefore computed the value of goodwill of the firm and determined the 9% share therein as the share of the assessee which became subject-matter of gift amounting to Rs. 1,67,650/-. On appeal, the Appellate Assistant Commissioner held that the moment the assessee has retired, the right to share in the future profit of the firm came to an end and there is no question of giving up any right to share in the future profit. On this ground the order of assessment was set aside. The tribunal, on appeal filed by the revenue, affirmed the order of A.A.C.

3. Learned Counsel for the revenue has urged that goodwill of a firm is a tangible asset capable of transfer and as the assessee has not taken his share in the goodwill at the time of retirement which amounts to

transfer without consideration in favour of incoming partners to the extent it represents share of retiring partner. He relies for that purpose on the decision of the Supreme Court in Commissioner of Gift-tax, Gujarat v. Chhotalal Mohanlal, 166 ITR 124.

4. There is no doubt that goodwill is an asset of a firm and like any other asset of the firm is capable of being transferred. At the same time, it is equally true that retirement of a person from a firm and taking accounts at that time does not involve any transfer of property as such. It is a matter of settling accounts while parting company. What consideration prevailed for determining a sum payable to the outgoing partner isa matter of settlement between them and a question of fact.

5. Section 55 of Partnership Act envisages that in settling accounts of a firm after dissolution, the goodwill may, subject to contract between the partners, be included in the assets and it may be sold either separately or along with other property of the firm. This provision envisages that the dealing with the goodwill at the time of dissolution of a firm can be subject-matter of a contract. It may be valued and accounts may be taken on that basis. It may be valued and sold separately or along with other property of the firm and accounts maybe taken or it may be that some of the partners be allowed to retain the goodwill of the firm and continue to carry on business in the same name and style. In the very nature of things where retirement of a partner is envisaged without dissolution the parting of goodwill by the firm does not arise. Retirement of a partner and continued existence of the firm carrying on the same business by the remaining partners postulates that the firm carries on the business with the goodwill. Be that as it may, it is ultimately a question of contract between the parties as to the settlement of accounts whether the goodwill is to be taken into account or not.

6. For the purpose of inviting operation of gift tax, the first condition is that there must be a transfer from one person to another. The revenue authorities have all through proceeded on the assumption that on assessee's retirement by not taking the share of goodwill from the above firm has resulted in relinguishing of his rights to share of profits of the firm in future in favour of incoming partners. As a matter of law, we do not find any support for such assumption. If retirement of a person from the firm by itself results in a transfer, while settling accounts with the firm, it is

between the retiring partner and the remaining partner or partners. The incoming partners do not come into scene at all in such situation. The fact that subsequent to retirement of A, the other partner induct new partners also does not establish that retiring partner has relinquished his interest in goodwill in favour of incoming partners, unless it can be shown that retirement of A was conditional on induction of new partners nominated by him. Ordinarily after retirement of partner A, induction of new persons as partners by remaining partners is a matter of agreement between them. If remaining partners induct new partners without consideration by way of contribution in capital or contribution in working of the partnership business it may amount to diminishing of then existing partners' share in favour of incoming partners. But in no circumstance, it can result in transfer of share of retiring partner to incoming partners without consideration. In that event, enquiry must necessarily direct towards consideration between retiring partner and incoming partners. There has to be overt act of transfer of interest of retiring partner in favour of new incumbents who may or may not be admitted to partnership by the remaining partners as that would be a matter of agreement between the remaining partners and other partners inducted into a firm. As a fact, we do not find any foundation that the assessee had agreed not to take share in goodwill for the purpose of inducting new partners nominated by him and new partners were inducted in consideration of such agreement. It will be relevant to notice that in the present case the induction is not only of sons of the retiring partner but of strangers also. There could be no foundation to assume that the assessee retired to make room for the new partners to share the future profits or the spoils of goodwill of the firm by the strangers.

7. It may be noticed that what has weighed with the A.A.C. as well as with the tribunal, while affirming his order, is the principle that right to share in the future profit of the firm does not exist and there cannot be any gift of a non-existent asset. A goodwill is a transferable asset but the dealing of goodwill at the time of settling accounts was between the remaining partners of the firm and the assessee. As no transfer takes place between the partners or from the firm to the partners or vice-versa, as a result of dissolution of the firm or on retirement of the partner, the taxability of the event was rightly not founded on the basis of transfer of share in the goodwill from the assessee to the remaining partners who in turn decide to have a

larger firm by inducting new persons on contribution of capital from each one of new partners with different percentage of profit sharing. The new incumbents have been inducted in the firm for consideration that is apparent from the deed of partnership which has been made part of statement of case. So far as new partners are concerned none of them has acquired any interest in the profits of firm in gratis. The only possible alternative which commended the revenue to bring the amount to tax was to consider it transfer of future right to share in favour of new incumbents which as discussed above, in our opinion, has rightly been not accepted by the tribunal.

8. The question as to whether right to share future profit is a transfer which could be subject-matter of gift directly arose in Addl. Commissioner of Gift Tax, Madras-II vs. P. Krishnamoorthy and others, 110 ITR 212. The court, in the first instance, referring to the question, said,

> "The Gift-tax Officer was of the view that as a result of the retirement of the assessees from the partnership, they had relinquished their respective interests in the partnership firm resulting in the diminution in their interests and corresponding increase in the value of the shares in the hands of the continuing partners and this constituted a gift liable to tax under the Gift-tax act. The Appellate Assistant Commissioner, on appeal, held that as the assessees when they retired were given whatever they were entitled to as per the partnership deed, there was no question of the assessees relinquishing their shares of interest with intent to diminish the value of their own property and increase the value of the property of the continuing partners on such retirement and hence there was no gift liable to tax."

Coming to the second aspect of the matter, the court said,

> "even if the right of a partner to share the profits of the firm is considered to be "property", there is no question of a retiring partner having a right to share future profits and such a non-existent right cannot be 'property' as contemplated by the statute. The moment a partner retires from a firm, he will have no right to receive any future profits in the said firm and hence there is no question of his giving up any such right."

Viewed in this light, the question of relinquishing right to share future profit resulting in a gift in favour of incoming partners do not arise. As far as the question of settling accounts at the time of retirement is concerned, the law is fairly well-settled that taking of accounts on retirement or distribution of assets on dissolution of firm does not entail any transfer.

9. In Commissioner of Gift-tax vs. K.G. Raghu, 210 ITR 979, a bench of Kerala High Court held,

> "We are of the view that the appellate tribunal was justified in holding that there was no transfer of property in the instant case and so no gift is involved in the matter when the respondent retired from the firm and received amounts due to him."

10. What is the amount due to a partner at the time of retirement is a question of fact depending on the contract between the parties and what is agreed at the time of settlement of accounts. The ITO or for that matter the other authorities have not at all examined the context in which the observation has been made that the assessee hhas not taken his share in goodwill at the time of retirement. We cannot speculate in the absence of any enquiry and finding on that basis whether not taking of goodwill was as a result of any agreement to the contrary or an act of voluntary relinquishment of the part of amount due to him on retirement for inducting new partners, as there is no finding to the effect that assessee received something less than what was due to him under agreement of partnership between the assessee and his partners in lieu of inducting new partners. In such an event the question whether the assessee receiving any sum by way of settling accounts less that what becomes due on settlement of accounts as per the agreement between the parties amounts to a transfer and gift do not arise for consideration.

10. The decision relied on by the learned counsel for the revenue is beside the issue raised in this case. It was a case in which the assessee had not retired. It was a case in which there were 3 partners, namely, C, G & P. C had 7 annas share, G 4 annas and P 5 annas. P had retired and 3 new partners were inducted by the remaining partners C & G which included 2 sons of C, K and D at 12% and 13% share respectively. P retired and R was brought at 25% share. G's 25% share remained unchanged and C's share diminished to 25%. Finding was also there that

status on capital account of the firm remained the same, that is to say, the minor sons K & D who have been inducted to the firm to the benefits of partnership had not contributed anything of their own to the share capital. They being minors, their participation in the working of business and contributing labour or expertise also cannot beassumed. In these circumstances it was found that by inducting minors to the benefit of the partnership which by reducing the existing share of C, and retaining the capital account status the same, amounted to a transfer of his share to the extent it was diminished in favour of his sons. That being without consideration, the transfer of share from the father to sons, both remaining as members of the firm, father with the reduced share with the same capital, was held to be transfer without consideration amenable to gift tax. It was not a case where a person has retired from the firm; while settling his accounts some adjustment has been made; and after retirement new partners have been inducted. The question whether in such state of affairs it would amount to a gift from retiring partner to new incumbents was not before the Supreme Court, nor was such an issue before the Madras High Court in P. Krishnamoorothy (supra) or before the Kerala High Court in K.G. Raghu (supra).

11. As a result of the aforesaid discussion, we answer the question referred to us in the negative, that is to say, in favour of the assessee and against the revenue. The assessee has not appeared in spite of service. In the circumstances, there shall be no order as to costs.

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